Does Islamic Banking Differ from Conventional Banking?

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Abstract

I study Islamic accounting and how it is developed in the marketplace, especially in the banking sector. There are many types of research study and explain the differences between conventional and Islamic banking, and how the accounting standards differ from Islamic accounting. Almost all of the previous studies depend on the comparison between specific ratios by analyzing the annual reports and studying the differences between these ratios. In this research, data are collected through an interview to explain how Islamic banking differs from conventional banking. The results of this study explain the main differences between both banks which are in the interest in loans and deposits, how the banks finance their clients and accept their deposits, the differences in risk management, and how they can invest their money without violation of Sharia.

Keywords: Islamic Accounting, Islamic Banking, AAOIFI, Sharia.

Introduction

Islamic accounting is defined as "the process of identifying, measuring and communicating economic and other relevant information, inspired by the Islamic worldview and ethics, and complied with the Sharia (Islamic law) – in order to permit informed judgments and decisions by potential and expected users of information– to enhance social welfare and seek the blessings of Allah". It is considered as a tool, which enables Muslims to evaluate their own accountabilities to God (Hamid, 2011).

The bank is considered the most important financial institution that manages the money of the investors, and the profit of the banks will be the difference between the interest that has been paid by the borrowers and the

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interest that has been paid to the depositors. Moreover, the bank introduces many financial facilities and services to their customers, such as credit services, cashing checks, issuing letters of credit and letters of guarantee, safety deposit boxes, portfolio management, foreign currency exchange services, acquisition of commercial papers, bank acceptance and underwriting of financial instruments (Aladwan, 2015).

The Islamic banking system works in the same way as conventional banks but without interest, due to the effect of the interest on the investors. Islamic sharia laws prohibit interest because the interest payments would increase the payment on the loans to the borrowers. Consequently, the interest payments are unfair to the borrower and lenders from Sharia's point of view. Moreover, Islamic banks apply the Islamic laws in their financial investments by applying the concept of financial intermediation, which is based upon the principle of participation in the profit and loss. Besides, Islamic banks have introduced more than forty Islamic financial products to their customers, such as accepting demand and time deposits, cash transfers, cashing checks, foreign currency exchange services, acquisition of the commercial papers and safety deposit boxes (Aishath et al., 2010).

The main reason for our study is to differentiate between Islamic and conventional banking. There are different points of views that discuss the following issue: is Islamic banking really differs from the conventional ones or its just changes in wording in order to say that they are complying with Sharia? I study the above issue and try to answer the question by providing the major similarities and differences between Islamic and conventional banking. In other words, I try to answer the following questions: First, what is Islamic Accounting? Second, what are the differences between conventional accounting and Islamic accounting? Third, are the Islamic accounting and their standards corresponding to the real Islamic (sharia) standards or it is just changing in names and concepts? Fourth, what are the main differences in conventional banks and Islamic banks? Fifth, why some of the conventional banks are interested in applying the Islamic accounting system into their systems?

This study examines the various features of Islamic accounting along with the benefits and its comparisons with the conventional accounting system. In addition, the study clarifies the importance of the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI). It compares between Islamic and conventional banks in Jordan by studying the borrowing facilities, Deposits and their Risk management, and how Islamic banks are being developed and added value to the country.

Our analysis is based on interviews, as most previous researches were based on comparisons between ratios to find the difference between conventional and Islamic banks. In regard to disclosure, there are no differences between conventional and Islamic banks since both banks follow international standards in the disclosure process. Through the interviews, I find the differences between the two types of banks.

The study contributes to the literature by analyzing the differences between the conventional and Islamic banks to show how it differs, as one of the sectors that use the Islamic accounting model, and to figure out whether if there is a real difference in the process and concepts between the two models. In addition, I try to reach a conclusion whether I really need to implement an Islamic accounting system, is it useful and it will add value to the society, or the conventional system is better to implement?

Our results can be summarized as follows: First, the major differences between Islamic and conventional banking is that Islamic banks do not deal with interest either on the assets or on liabilities. Second, there is nothing in Islamic banks called the loan. However, in some humanitarian cases, like education, for instance, Islamic banks provide an interest-free loan called (AL-Qard AL-Hassan). Third, regarding the deposits, unlike the conventional banks, Islamic banks do not provide a fixed interest to the client, but both the clients and the banks share the profit and loss on a partnership agreement. Fourth, both Islamic and conventional baking has mutual types of risks. Fifth, unlike the conventional banks that invest their money in any project that generates a high profit, Islamic banks must invest the money from the clients' deposits in projects that conform to the Sharia standards. Finally, Islamic banks have not been affected by the financial crisis compared to the conventional banks, since Islamic banks do not provide customers with fixed interest on deposits but instead, they use a partnership-based agreements with their customers in which both the customer and the bank share profit and loss due to ratios agreed in the contract.

This paper consists of four more sections. Section 2 summarizes the literature review. Section 3 introduces the Islamic Accounting and Islamic Banking. Section 4 explains the methods and methodology. Finally, Section 5 summarizes and concludes the study.

Previous Literature

Olson and Zoubi (2008) study whether it is possible to distinguish between conventional and Islamic banks in the Gulf Cooperation Council (GCC) region based on financial characteristics alone. Islamic banks operate under different principles, such as risk-sharing and the prohibition of interest. Yet, both types of banks face similar competitive conditions. The combination of effects makes it unclear whether financial ratios will differ significantly between the two categories of banks. The authors study the differences between Islamic and conventional banks under risk-sharing and interest. They conclude that most of the financial ratios are similar and some of them are near to each other and Islamic banks, unlike conventional banks, share the risk with their clients.

Lawal (2010) defines Islamic Banking as a system of banking that is consistent with the principles of Islamic law (Sharia) and its application through the development of Islamic economics. It is the most important features are the abhorrence of interest rate, profit and loss sharing between the investors and the entrepreneur.

Beck et al. (2013) determine how different are Islamic banks from conventional banks? Does the recent crisis justify a closer look at the Sharia-compliant business model for banking? When comparing conventional and Islamic banks, controlling for time-variant country-fixed effects, the authors find a few significant differences in business orientation. There is evidence, however, that Islamic banks are less cost-effective, but have a higher intermediation ratio, higher asset quality and are better capitalized. They also find large cross-country variation in the differences between conventional and Islamic banks as well as across Islamic banks of different sizes.

Abdel Karim (2001) finds that Islamic banks perform both commercial and investment banking services but do not establish firewalls to separate these two services legally, financially, and managerially. Unlike conventional commercial banks, Islamic banks are prohibited from charging or paying of interest. Instead, Islamic banks offer profit-sharing investment accounts, such that investors' return depends on the return on the assets financed by the investors' funds.

Khan (2010) reaches for the result that Islamic Banks hold well over US $700 billion in assets and are growing at over 15% p.a. Islamic Banking and Finance (IBF) involves wider ethical and moral issues than simply ‘interest-free’ transactions. Its advocates argue that these make it more economically efficient than conventional banking and promote greater economic equity and justice. A preliminary investigation shows that three decades after its introduction, there remain substantial divergences between IBF's ideals and its practices, and much of IBF remains functionally indistinguishable from conventional banking. This runs counter to claims by IBF advocates that it would rapidly differentiate itself from conventional banking. However, despite not providing an alternative to conventional banking and finance, IBF does strengthen a distinctly Islamic identity by providing the appropriate Islamic terminology for conventional financial transactions. The author notes that Islamic banking finance is more concerned with the ethical and moral issues than conventional banks which are argued that it leads to more economic efficiency, promote greater economic equity and justice.

Samad (2004) examines the comparative performance of Bahrain’s interest-free Islamic banks and the interest-based conventional commercial banks during the post-Gulf War period with respect to (a) profitability, (b) liquidity risk, and (c) credit risk. Nine financial ratios are used in measuring these performances. Applying Student’s t-test to financial ratios for Islamic and conventional commercial banks in Bahrain for the period 1991-2001, the paper concludes that there is no major difference in performance between Islamic and conventional banks with respect to profitability and liquidity. The author states that the main difference between conventional and Islamic banking is the credit performance that depends on its nine financial ratios analysis that is based on profitability, liquidity and credit risk.

Chong and Liu (2009) conclude that a unique feature of Islamic banking, in theory, is its profit-and-loss sharing (PLS) paradigm. In practice, however, they find that Islamic banking is not very different from conventional banking. Their study on Malaysia shows that only a negligible portion of Islamic bank financing is strictly PLS based and that Islamic deposits are not interest-free but is closely pegged to conventional deposits. The findings suggest that the rapid growth in Islamic banking is largely driven by the Islamic resurgence worldwide rather than by the advantages of the PLS paradigm and that Islamic banks should be subject to regulations similar to those of their western counterparts.

In summary, the previous literature defines the history of Islamic accounting, what Islamic accounting model is, and how it is applied in the recent days. It also studies the differences between the Islamic accounting model and the conventional accounting model by taking different aspects and using specific ratios. In this study, I analyze the differences between conventional and Islamic banks in order to show how it differs, and to figure out whether or not there is a real difference in the process and concepts between the two models in order to reach a conclusion if do we really need to implement an Islamic accounting system, is it useful and will it add value to the society, or the conventional system is better to implement.

Islamic Accounting and Islamic Banking

1. Islamic Accounting

1.1 Introduction

Because of the growth of Islamic financial markets and institutions, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established on 26th of February 1990 in Algiers, and then, registered on 27th of March 1991 in the Kingdom of Bahrain, as an international not-for-profit Islamic corporate body that prepares standards for Islamic Financial Institution (IFIs). As an independent international organization, AAOIFI is supported by institutional members (200 members from 40 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide.

AAOIFI has gained assuring support for the implementation of its standards, which are now adopted in the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan, and Syria. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, the Kingdom of Saudi Arabia, and South Africa have issued guidelines that are based on AAOIFI's standards and pronouncements. Total of 88 standards issued: (a) 48 on sharia, (b) 26 accounting, (c) 5 auditing standards, (d) 7 governance and (e) 2 codes of ethics. In addition, new standards are being developed and existing standards reviewed. AAOIFI standards are followed – as part of regulatory requirements or IFIs' internal guidelines – in jurisdictions that offer Islamic finance across the Middle East, Asia Pacific, South Asia, Central Asia, Africa, Europe, and North America, and Islamic Development Bank Group. Consequently, AAOIFI standards have introduced greater harmonization of Islamic finance practices across the world. (Source: http://www.aaoifi.com/en/about-aaoifi/about-aaoifi.html)

1.2 The Need for Islamic Accounting

It is widely accepted that the primary objective of accounting is to provide useful information to assist users in making economic decisions. Thus, it can be argued that accounting is, therefore, a religious obligation. Hence, if accounting is a religious obligation, then the rules of accountability must be purely divine. In order to do so, it is necessary to have Islamic accounting to be in place rather than conventional accounting to provide information on financial success in Islamic organizations. The Accounting and Auditing Organization for IFIs (AAOIFI) was formed for this reason.

1.3 The differences between the conventional accounting model and the Islamic accounting model

Hamid (2011) highlights and explains the differences between Islamic accounting and conventional accounting to show the differences between these two accounting practices. The focus relies on the source, objective, accountability, and disclosure of both accounting.

- **Sources**

Islamic accounting is the only accounting practice in this world that made all accounting processes guided by religion sources. However, for the conventional one, the development of this science only based on human law besides deserting some ethical value. However, for conventional accounting, the law in this accounting only created based on human experience, knowledge, and thinking.

- **Objectives**

Basically, the conventional accounting's objective is only to fulfill the interest of an influential person in the field but for Islamic accounting, the objective is more than that. For Islamic accounting, all the activities aim to get a blessing from God, the accountant must ensure the accounting activity and process follow the principle of Sharia which the information detail in accounting must show clearly and separately with the prohibited earning and expenditures either in the business or in the government.

- **Accountability**

For Islamic accounting, accountability is to involve the essential goal in

Islam because the belief is that resources are provided to an individual from God in the form of trust. Therefore, from this, everyone will be accountable for his or her action as a trustee to God. The accountability for conventional accounting seeks to address the pattern of inequality and marginalization that are globally present, and its strategies aimed at challenging power to resonate with poor people's experiences. This will absolutely violate the poor and needy people in accounting and business.

- **Disclosure**

For Islamic accounting, the term disclosure actually has related to the concept of social accountability in Islam that is involved with the principle of full disclosure. While for the conventional accounting, the disclosure is only emphasized on users' requirement of information, which means only limited disclosure provision of information subject will be provided for the public interest. In other words, Islamic accounting disclosure relates to social accountability, which is involved with the principle of full disclosure, which really differs from conventional accounting that is more to private sociability and limited disclosure. Table 1 summarizes the differences between the two models.

Table 1: The main general differences between Islamic and conventional accounting model

Elements	**Islamic model**	**Conventional model**
Fixed interest	Prohibited	Used
Ethics	Professional ethics	Religious ethics
Antecedent and Legislations for Reporting	based upon ethical law originating in the Qur'an and Sunnah	based upon modern commercial law
Bonds	Yes, with request condition	Yes
Type of information	socio-economic and religious events and transactions	economic events and transactions
Accounting Theory	the proprietary theory	accounting entity theory
Accountability	Personal accountability	accountability to fellow human beings, ultimate transcendental accountability to Allah

1.4 Islamic Banking

Islamic banking has the same purpose as conventional banking except that it operates under the rules of Sharia, known as "Fiqh al-Muamalat" (Islamic rules on transactions). Islamic banking activities must be practiced consistently with the Sharia and its practical application through the development of Islamic economics.
(Source: (http://www.islamic-banking.com/what_is_ibanking.aspx).

Islamic banking, beginning from the Middle East, first established in Jeddah-Saudi Arabia, has grown into a worldwide phenomenon with Islamic financial institutions now operating in more than 75 countries worldwide.

Islamic banking is banking activity that is consistent with the principles of sharia law and its practical application through the development of Islamic economics, which prohibits the payment or acceptance of interest (riba) for money loans or investing in businesses that provide goods or services that are sinful and prohibited in Islam (haram).
As a financial intermediary, the basic mechanism of the Islamic bank is to accept deposits from surplus units on the liability side and offer to finance on the assets side to the deficit units. (Source: http://www.oracle.com/us/industries/financial-services/islamic-banking-process-wp-1898554.pdf).

2. Methodology and Methods

2.1 Introduction

To study the main differences between both types of banks, the data collection is based on interviews with key persons who are working in Islamic and conventional banks. Our sample consists, in total, of eight banks, four are conventional and the other four are Islamic. There are only three Islamic listed national banks in Jordan which are: Jordan Islamic Bank, Islamic International Arab Bank, and Jordan Dubai Islamic Bank. I add Al Rajhi Bank as the only international Islamic bank in Jordan. On the other hand, I choose the largest three national conventional banks in Jordan due to the following standard: Total Assets, Paid-in Capital, Shareholder Equity, Customers' Deposits, Loans, Net Loans, Earnings per Share (EPS), Book Value per Share, Assets Growth, Deposits Growth, Total Deposits and Net Income. According to the above Standards, the banks as of June 31, 2014 are: Arab Bank that is ranked the largest bank in Jordan, the fourth in Asia and 70th worldwide, Housing Bank for Trading & Finance which is ranked the second bank in Jordan, the 55th in Asia, Jordan Kuwait Bank which is ranked the third bank in Jordan. To be consistent, I choose Bank Audi as one of the best International conventional banks in Jordan.

2.2 Our Interviews with the commercial Banks

The main differences that I conclude from our interviews are in:

1. Loans
2. Deposits
3. Investments
4. Risk Management

Loans: It is divided into two parts, the first part is retailed loans and the second part is corporate loans, the first part is divided into two types, personal loans, and housing loans.

A personal loan can be used for any personal expenses without having a designated purpose. In personal loans, there are many reasons to lend to the client. For example, to buy a car, for education expenses, personal and housing supplies, personal obligations, and so on. Like other loans, personal loan terms depend on the clients' credit history. The second type is the housing loan, which offers financial leasing for the purchase of residential apartments, lands and the construction of residences or the maintenance of an existing property. It is offered to individual employees in the public or private sector and to middle and high-income self-employed individuals. In addition, to the possibility of granting the loan without a limit and the ability to finance up to 90% of the property's value in the case of purchasing a house and 100% in the case of building one. The interest rate for personal loans is higher because the guaranties are less and maybe the client stumbles for the monthly payment. Examples of guaranties in the personal loans are salaries (the most common), mortgage of house, land, car and so on. In the corporate loans, the bank divides the companies into three categories depends on the size of the company (Large, Medium and Small) and the business type, the interest rate depends on business type and the purpose of the loan such as Investing, trading, constructing, and so on. The interest rate on large companies is less than that in small companies because the guaranties are more. The calculation of the interest rate on the loans depends on Jodibor, a rate that is determined by the central bank, plus an additional rate that is added by the bank to

Jodibor. For example, if the central bank determined that the interest rate on loans (the Jodibor) is 5% and the bank determined that its fixed rate is 2%, then the interest that the bank offers to their clients is 7%. If Jodibor is increased or decreased, the interest rate will be affected when the bank renewal the loans contracts every year but the fixed bank rate (2% in this example) will be fixed and does not change.

The percentage of a fixed rate that is added by the bank depends on the status of the bank. When the bank has a shortage of liquidity, it increases the percentage of interest either for banks or customers to attract them, while when the bank has extra liquidity, the percentage of interest is decreased. However, the percentage should not exceed the amount allowed by the central bank. There is a special case where the customer receives the maximum interest rate allowed from the central bank for elite customers. The percentage of interest on loans taken from customers depends on the monetary policy which the Central bank implements. The Central bank controls the percentage of interest according to the economic conditions in the country. For example, if there is inflation, deflation, economic crisis or economic recovery.

The loans in the conventional banks depend on whether the client is a company or an individual and how much income or salary each party achieves monthly. In addition, there will be a classification based on that, which determines the amount of interest that the customer should bear on the loan requested. For example, the bank may request an interest rate of 7% for class A, while 9% for class B. The second aspect that the bank takes into consideration is the ability of the bank to cover the costs whether it is operational or other costs, taking in mind the profit that has to be achieved to compete with other banks.

To achieve a high market share and return on investment, the bank must provide an interest proportional to the risks that may occur, in addition to the profit that can cover the different types of costs that the bank bears. In conclusion, the bank decides the percentage of interest to cover the costs and to generate profit. This percentage is not fixed, as it is being discussed weekly through a meeting with the funding committee.

Cards: it is a facility offered by the bank to its clients and it consists of two types; the first is the debit card (ATM) that linked with the client's account. The clients can withdraw from their accounts with a limit. The limit depends on the bank and the clients' accounts available. The second is the credit card. The clients can withdraw or purchase without having balances in their accounts. Credit cards are divided into two types: revolving and chargeable. In revolving cards, there are monthly payments that should the clients pay; the minimum payment depends on a specific percentage of what the client spent during the month. In the chargeable card, on the other hand, the client should pay 100% of his/her monthly statement. Credit cards have different limits. They are similar to the principle of loans. There should be guaranties like the salary must be transferred to the bank, the client has good credibility, or he pays a down payment to the bank as a trusteeship. Furthermore, if the client delayed for monthly installment, there will be fines.

Deposits: deposits are divided into three categories: current account, saving account and fixed deposit. In the current account, the client can deposit his/her money without taking interest and he/she can withdraw the money at any time. The investment in the current account is made through collecting the money available from different currencies, as the most used currencies are the U.S. dollar, euro, Sterling pound, Japanese yen, and the Jordanian dinar. The money is invested in its certain currency separately for only one day. The process is known as overnight investment. For example, the Jordanian dinar is invested by depositing the money in the central bank for one night, and the central bank decides the percentage of the interest on this deposit, which is currently 2.75%, or through depositing the money in other banks in Jordan. Whereas the U.S. dollar is invested by depositing the money in a correspondent bank in the United States of America and the percentage of the interest is decided from the correspondent bank. The reason for investing for only one night is that customers can always withdraw the money from the account during the next day since this type of account (current) is not restricted to a certain period.

The saving account is similar to the current account except that the bank pays an interest to its clients. In the saving accounts, the bank invests the money for a period of one week in all currencies separately. Since the transactions on this account are limited, the bank can always cover the amount of money being invested at the time the customer wants to withdraw from any other saving account.

Fixed deposit which is a financial instrument provided by the bank to investors with a higher rate of interest than the regular saving account until the specified maturity date. In the fixed deposit, the clients deposit their money, but they cannot withdraw the money until the period of the deposit ends. In some cases, the client can withdraw the money, but he/she will lose part of the interest that promised to be paid by the bank. The interest rate in deposits depends on the period, amount invested, and the reputation of the client. The longest allowed term is 10 years.

Risk Management: There are various types of risks in the bank like general risks, loan risks, and deposit risks. Examples of general risks are fire, fraud (Transactions, Signatures, checks, currency … etc.) and armed robbery. Loan risks result from the inability of clients to pay their payments. To protect their money, the bank should transfer the loan after 30 days to the allowance account as the central bank rules and Basil 2&3 states. If the clients do not pay their payments after 3 months, the bank asks their client to pay the whole amount of loan. Deposits risks result from decreasing the interest rate in the market. In this case, the bank will pay the stated interest rate on the deposits.

2.3 Our Interviews with the Islamic Bank

<u>Loans:</u> There are no loans in Islamic banks, as technically loans mean providing money to customers in return of a certain percentage of interest. In Islamic banks, this is prohibited. However, Islamic banks provide something called "Al-Qard Al-Hassan" in which the bank provides an interest-free loan where the bank provides the customer based on benevolence. From the "Sharia" point of view, it is permitted because it is non-cumulative in which the customer repays the bank with the exact same amount provided by "Al-Qard Al-Hassan" without any type of interest and it is considered as a donation from the bank to the customer.

Islamic banks provide funding through two concepts. The first is called "Murabaha" where the customer request funding from the bank to buy all goods or houses that the clients want to buy. Then the bank resells them to their clients with "Murabaha". Both the bank and the client agreed on the percentage of "Murabaha" in the contract. In addition, Islamic banks invest the money by buying lands, metals (like Iron, gold, wood, and so on.), oil and other sources that are “Halal” and permitted by "Sharia" principles and resell them to generate profits. Also, the Islamic banks can generate "Murabaha" by investing their money in the Islamic market such as the market of Malaysia. The second is "Ijara" where the customer request funding for buying a property, so the bank buys the property and rent it to the customer by monthly rent. When the customer pays all the settlements, the bank transfers the ownership of the property to the customer as a "Heba" (Gift). If the client could not afford to pay the rest of the amount for certain conditions, the bank will not renew the contract with him, and they will figure out a way to sell it.

When a customer takes a fund from an Islamic bank, he will never have to pay a fine in case of delay in settling the monthly installments, even if the customer failed to pay the installments for a long period and a court case was aroused against him. There will be no extra charge on the monthly installments that have to be settled.

For example, to finance the client in getting a car using Murabaha, the bank buys the car then sells it back to the client. The process goes as follows: the client provides the bank with the required car. The bank investigates and makes sure that the information is provided truly. The client pledges to buy the car. The bank gets insurance to the car during the period of the car's ownership. Both the bank and the client sign the agreement contract, which contains the price of buying the car and selling it back to the customer. Finally, the amount of "Murabaha" and the amount that should be paid monthly. If the client Abandoned or cannot afford to pay, the bank will find another client or sell the car in a public auction.

<u>Cards:</u> Although it is prohibited for Islamic banks to provide a loan. However, to satisfy their customer needs, Islamic banks provide different types of cards, but with zero interest only in return of certain fees agreed upon with the customer. The first type is the Visa Electron (ATM) in which the customer withdraws from his own current account without any type of credit during the process of withdrawing. This is considered as a service provided by the bank to its customers. The second type is the Charged Visa where the customer account would be zero. This type of card enables the customer to buy a product, service, or withdraw money from any ATM machine instead of going to the bank and withdraw from a teller. Both Islamic banks and conventional banks place a certain limit on the card in which the customers withdraw cannot exceed. The difference between Islamic banks and conventional banks in this type of card is that in Islamic banks, the customer repays the face value of the amount withdrawn plus a certain amount of fees, which has really been incurred by the bank. In a conventional bank, the customer has to repay the same amount plus a certain percentage of interest, in addition to fees on each process of withdrawal using the card. The third type is the Revolving card in which the customer can purchase a product or withdraw a certain amount of

money and he pays the money back through installments over a certain period. The customer in the Islamic bank repays the exact amount of money withdrawn from the card, wherein a conventional bank, the customer repays the same amount plus a fixed percentage of interest agreed upon with the customer.

<u>Deposits:</u> The deposits in Islamic banks are divided into current accounts and investment account, both do not provide a fixed interest rate but with a percentage of profit according to an agreement with the customer according to the investments in different projects. The investment accounts are divided into "Idekhar" and "saving" without a fixed base interest. In the current account, there is no profit or loss for the clients. However, if the bank invested the money and earned a profit, it will be only for the bank. In the investment accounts, the clients ask the bank to invest their money. This money will generate profit or loss that will be shared with clients. There is a specific percentage will be distributed to all customers, almost 40% of the profit as "Murabaha.

Islamic bank receives deposits from customers through a contract called "Mudharabah" where the customer provides the capital and the bank plays the role of a partner and invests the money. The profit or loss is distributed between the two parties according to the agreement set between them from the beginning, while the conventional bank receives deposits from customers as loans. In Murabaha, the bank buys the required goods for the client under certain conditions then the client should pay the amount agreed upon the agreement between both sides. If the client can pay the entire amount at any time later, then he can do without benefits, not like the conventional banks, the client gets benefits to decrease the amount of the interest he pays.

In Islamic banks, you can deposit your money, but the banks do not promise you to pay any rate of interest. If the bank has any loss, the client should bear a specific percentage of the loss. The amount of money that the Islamic bank pays to the clients called "Murabaha" instead of interest. When the client deposits the money, the bank invests the money in various types of investments not prohibited in "Sharia". It should be "Halal" (according to Sharia regulations). Islamic banks do not invest their money in the markets with high risk but with low ones. The banks can tell their clients that the "Murabaha" percentage last few months was 3%, for example, and this percentage may decrease or increase during the period of the client's deposit.

Risk Management: Islamic banks bear the risk of ownership. For example, if the bank bought a car that costs JD10,000 and sells it to the customer by JD12,000 the profit will be JD2,000. To be accepted as "Halal", the bank should bear any depreciation or damage before the transfer of ownership to the customer. There is also another kind of risk in Islamic banks called "violation of the sharia board". For example, if the bank employee signs a selling contract with a client before buying the product, the profit from this transaction is not accepted according to sharia and the profit of such a case should be distributed as a charity.

2.4 Summary comparison between Islamic and conventional banks

The differences between both banks that can be summarized as follows:

1- Saving accounts and fixed deposits in conventional banks are used to save the clients' money and generate a percentage of the interest rate. No saving accounts or fixed deposits in Islamic banks because the principles of "Sharia" prohibited paying interest to others. Current accounts in both banks are similar because the clients deposit their money without interest and they can withdraw their money at any time they want, it is like trusteeship.

2- Documentary credits of the bank are riskier in Islamic banks than in conventional ones because Islamic banks bear all the damages that may happen to the products or goods during the banks' ownership. In commercial banks, the ownership will not be transferred to the bank, so the client will bear all the damages that may happen. In addition, if the Islamic bank has a process that is not authorized by Sharia and generates a profit, the bank should donate this profit because this income is considered "Haram" (prohibited).

On the other hand, there are two types of risks that exist in conventional banks; the first type is the deposit's risk, in which, there is always a fixed percentage of interest that the bank has to provide the customer on deposits even though there is a decline in the percentage of interest at the bank for any reason. This fixed percentage should be paid to the customers under all circumstances. The second type is the risk that is come from loss in investments. This loss will not be shared with customers while in Islamic banks; the loss in any investment is shared with customers.

3- Islamic banks are never based on the concept of interest neither on assets nor on liabilities. Islamic banks do not have interest in terms of providing customers with a fixed amount of interest whether there is loss or profit but work on a partnership with the customer by investing money in different projects such as (gold, lands, Malaysian palm oil). If the bank generates profit, the client gets benefit while if the bank generates a loss, the client bears the consequences. However, there are differences in Islamic banks in Jordan in the way they invest the money, but they all share the same golden rule, which indicates that it is prohibited to place a fixed profit percentage before investing the money to the customer. The bank may invest in projects with high-risk but also with a high percentage of profit or in low-risk projects with low profit.

4- Conventional banks have to deposit a certain amount of money at the central bank and the central bank pays interest for that. On the other hand, Islamic bank may deposit the same amount of money at the central bank but without any interest or benefit. Islamic banks may get affected since their money will be held for a certain time without generating a profit. This also might affect the client because it may decrease the amount of profit he receives.

5- There are different types of risks at Islamic banks that differ from conventional banks. The first type of risk is the risk of "Ijara" where the bank buys an item for the customer on a renting base. The bank bears the cost of any depreciation occurs on the assets. The second type is the risk of "Murabaha", where the bank buys the item to resell it to the customer. The bank bears the cost of any damages may occur before transferring the ownership to the customer. The third type is the risk is violating the resolution of the "Body of Al-sharia". When any violation of the resolutions happens, Islamic banks are obliged to take the amount of money that is considered against the "Sharia" and pay it to charity organizations.

6- During the global economy breaks down, Islamic banks do not lose money as much as conventional banks because the profit in conventional banks depends on providing loans while in Islamic banks, all the products are owned by the bank and if the client cannot settle his payment, the bank can sell the product since the bank owns it. Conventional banks can only sue their clients with the assurance that the bank will get his money back.

7- Islamic banking transactions have banking appropriations. This means that the products should be owned by the bank, then the bank will sell it back to the client, the client should agree to pay all the amounts when he receives the products if all the products are matching to all the specifications that are agreed upon. If the client delay in paying his obligations, no interest will be added, unlike conventional banks, they fine their clients with interest for each delay day.

Conclusion

The study differentiates between Islamic banking concept and conventional banking concept in order to study the major differences between them. I define Islamic accounting concepts; their standards are set by the law of God and the "Sharia". The responsibility of setting and providing Islamic standards is AAOIFI. I provide the differences between the Islamic model and the conventional accounting model. I describe the Islamic banking concept that does not deal with interest and has its own concepts and procedures and deals with profit sharing and it does not provide loans, unlike conventional banks. After analyzing the interviews, I summarize our conclusions in the following:

1. The major difference between Islamic and conventional banking is that Islamic banks do not deal with interest either on assets or on liabilities.
2. Islamic banks do not use loans. However, in some humanitarian cases, like education, for instance, Islamic banks provide an interest-free loan called (AL-Qard AL-Hassan).
3. Regarding deposits, unlike conventional banks, Islamic banks do not provide a fixed interest to the client. However, both the clients and the banks share the profit and loss of a partnership agreement.
4. Both Islamic and conventional baking has mutual types of risks. There are types of risks that are only in Islamic banks. The first type is the violation of the resolution of the "Sharia" board. The second type is the risks in the Murabaha contract. On the other hand, conventional banks bear the risks of the fluctuations in the interest rates.
5. Unlike conventional banks that invest their money in any project that generates a high profit, Islamic banks must invest the money from the clients’ deposits in projects that conform to "Sharia" standards.
6. Islamic banks are not affected by the financial crisis compared to the conventional banks since Islamic banks do not provide customers with fixed interest on deposits but instead, they use a partnership based agreements with their customers in which the

customer and the bank both share profit and loss due to ratios agreed in the contract.

7. In order not to lose any of their clients who prefer to consider Islamic views in bank transactions, some conventional banks start to create a department that is responsible only for Islamic transactions and to follow the "Sharia" standards in their investments.

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